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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF OF PETITIONER TRANSWESTERN PIPELINE COMPANY

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This brief is respectfully submitted by Transwestern Pipeline Company ("Transwestern") in reply to briefs filed by the Federal Energy Regulatory Commission ("Commission") and Southern California Gas Company ("SoCalGas").

The briefs in opposition, through repeated references to "tariff" provisions, seek to induce acceptance of the concept that Order No. 380 deals only with tariffs and "rates." Thus, the Commission in its Question Presented

refers solely to the elimination of gas costs from the tariff. No reference is made to contracts which the Commission had previously reviewed and approved under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982) ("Act"). No reference is made to minimum take provisions similarly approved, all of which Order No. 380 abrogates. Similarly, the SoCalGas statement of Questions Presented refers only to provisions contained in tariffs.[1] No reference is made to SoCalGas' September 25, 1967 contract with Transwestern. (See TW Pet. A-1).[2]

1. The Effect of Order No. 380 on Transwestern's Gas Costs and Sales.

SoCalGas argues that Order No. 380 has had "its desired effect." (SoCalGas Br. at 4). A reduction in Transwestern's gas cost is cited as an example. It is implied that Order No. 380 has caused Transwestern to be the "low price leader of supplies to Southern California." (SoCalGas Br. at 4).[3]

As SoCalGas notes, Transwestern's commodity rate is currently less than that of its principal competitor, El

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[1] Tariff provisions setting forth minimum bill and minimum take obligations may have their origin in contracts negotiated between the pipelines and distributors which have been approved by the Commission under Section 7 of the Act and restated under Commission regulations in tariff form or through filings unilaterally made by pipelines under Section 4 of the Act, 15 U.S.C. § 717c (1982). *Cf. Atlantic Seaboard Corp. v. FPC*, 404 F.2d 1268 (D.C. Cir. 1968). The issues presented by Transwestern's petition address solely minimum bill and minimum take provisions which are based on contracts which have been formally reviewed and approved by the Commission in proceedings under Section 7 of the Act.

[2] References to the Appendix are shown as "App. - ——." References to the separate appendix included with Transwestern's petition are shown as "TW Pet. A - ——."

[3] This is misleading. Transwestern has been able to lower its price to California through the exercise of "market-out" clauses incorporated in contracts prior to the advent of Order No. 380.

Paso Natural Gas Company. (SoCalGas Br. at 4). What SoCalGas does not state, however, is that even under these circumstances, primarily because of SoCalGas' purchase practices not controlled by Order No. 380, Transwestern's sales to California are at perilously low levels.

During April, 1986, SoCalGas purchased only approximately 294 MMcf of gas per day from Transwestern. This represents approximately 40 percent of its daily contracted and certificated volume level. Prior to Order No. 380, Transwestern's sales were in the 700 MMcf per day range. Thus far in May, 1986, purchases by SoCalGas have declined further to less than 250 MMcf per day. Transwestern's market, as a result of Order No. 380, is being displaced by lower-cost, uncertificated "spot gas," as well as by higher-cost Canadian gas, which has been exempt from the effect of Order No. 380 and which is delivered through SoCalGas' affiliate, Pacific Interstate Transmission Corporation. (App.-114). Transwestern's other customer, Northwest Central Pipeline Corporation ("NWC"), is currently purchasing virtually no volumes from Transwestern, although Transwestern contracted with that company and was certificated by the Commission to sell it a total of 250 MMcf of gas per day. *Transwestern Pipeline Co.*, 34 FPC 659 (1965); *Transwestern Pipeline Co.*, 43 FPC 322 (1970). Like SoCalGas, NWC's alternative supplies include both higher and lower-cost gas. The overall effect on Transwestern has been that, notwithstanding substantial price reductions, drastically lower takes by SoCalGas and NWC as a result of Order No. 380 are creating substantial take-or-pay controversies with producers.[4]

The Commission asserts that petitioners cannot legitimately complain because they "have not been deprived of

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[4] A substantial number of lawsuits and arbitration proceedings are now pending against Transwestern as a direct result of lower takes arising from the operation of Order No. 380.

the principal benefit of minimum bill provisions." (Comm. Br. at 16). This argument is made in the context of the elimination of variable costs. It ignores, however, the principal benefits of minimum bill and minimum take provisions, admitted elsewhere by the Commission, in protecting the pipelines against incurring "take-or-pay" liability. (Comm. Br. at 4, 5).

The Commission's rationalization for disregarding the take-or-pay effect of Order No. 380 is inapplicable to Transwestern. It is also nonsense. As noted in its brief, the Commission assumes, first, that the pipelines "might be able to sell the requisite quantity of gas by lowering prices." (Comm. Br. at 20). There is no evidence that Transwestern can do so. The Commission maintains further that pipelines "might" be able to eliminate or reduce take-or-pay obligations through renegotiation. Transwestern has been unable to do so. Producers have little incentive to give up take-or-pay claims and lower prices for no more than a chance to compete for future sales. With no assured market, Transwestern cannot offer any long-term assured level of takes. Finally, the Commission asserts that, if the pipeline does incur take-or-pay costs, such costs may be included in rate base and recovered if it is deemed that such payments were "prudently incurred." (Comm. Br. at 20).

Transwestern now estimates that as a result of Order No. 380 its take-or-pay exposure for the years 1985 and 1986 is in the $350 to $400 million range. It cannot finance amounts of this magnitude. Transwestern's net worth, as shown from its 1985 Form 2 filed with the Commission, is approximately $250 million. Its net plant in service as of December 31, 1985 was approximately $306 million. Even if it could finance such amounts and include them in rates, the effect, particularly if the impact of take-or-pay payments were forced into the commodity rate, would likely be to increase Transwestern's rates to non-competitive levels, further reducing its sales

and exacerbating its take-or-pay problems. The Commission should not be permitted to brush aside the dire consequences of Order No. 380 by speculating that the pipelines can resolve whatever problems that rule might create.

2. Reply to SoCalGas' Characterization of Transwestern's Minimum Bill and Minimum Take Provisions as "Severe Tariff Restrictions."

SoCalGas states that the minimum take provisions in Transwestern's tariff require it to take from Transwestern, "regardless of its need and regardless of the cost," 600,000 Mcf of gas per day. (SoCalGas Br. at 3). SoCalGas argues that, whether or not it needed such volumes of gas on a daily basis, it was still required to take such volumes.[5] (SoCalGas Br. at 3). It describes the Commission's Order No. 380 series as relieving it of "severe tariff restrictions" and argues that such orders allow SoCalGas "to purchase gas based upon relative cost rather than on these tariff provisions." (SoCalGas Br. at 3). Repeatedly, SoCalGas and the Commission refuse to address the fact that, with respect to Transwestern and other pipelines, the "tariff" provisions about which they complain are merely restatements of contracts between these companies and the pipelines which the Commission has reviewed and approved in Section 7 proceedings. The "severe tariff restrictions" to which SoCalGas refers are contract commitments which it voluntarily entered into, urged the Commission to approve in certificate proceedings, and operated under for many years. (TW Pet. A-1).

3. Reply to Reliance on *Permian*.

Both the Commission and SoCalGas place substantial reliance on this Court's decision in the *Permian Basin*

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[5] SoCalGas does not mention its contractual arrangements, nor does it mention its total market requirements, a relatively small portion of which is supplied by Transwestern.

Area Rate Cases, 390 U.S. 747 (1968). It was expressly recognized there, however, that the Natural Gas Act was premised on contractual arrangements devised by the regulated companies and that the Act contemplated abrogation of those agreements "only in circumstances of unequivocal public necessity." *Id.*, at 822. The decision notes that "[t]he Commission conducted extended hearings. . . ." *Id.*, at 755. Specifically, it stated that the hearings began on October 11, 1961 and closed in September, 1963, that the final transcript included more than 30,000 pages, that an examiner's decision was issued, and that the Commission heard three days of oral argument prior to issuing its decision on August 5, 1965. *Ibid.* In short, the procedures underlying Order No. 380 bear no resemblance whatsoever to the procedures followed in *Permian*.

4. Reply to Claim that Order No. 380 Does Not Affect Service Arrangements Certificated Under Section 7 of the Natural Gas Act.

While the Commission repeats its rationale that Order No. 380 deals solely with "rates," not terms and conditions of service (see Comm. Br. at 11), neither it nor SoCalGas address the unassailable fact that the minimum take provision in Transwestern's contract with SoCalGas fixed the character of service it contracted and was certificated to provide. The abrogation of such minimum take provision is swept along with the elimination of variable costs for minimum bills. It should be borne in mind that, both with respect to sales made under minimum bill provisions and those made pursuant to minimum take commitments, the rates which the pipelines can charge the distributor customers cannot exceed just and reasonable rates as fixed and provided by the Commission under Sections 4 and 5 of the Act. Thus, SoCalGas' comment that it would be required to take gas from Transwestern "regardless of the cost" (SoCalGas Br. at 3) is not correct. Its right to oppose any Trans-

western rate filing was fully preserved by contract. (TW Pet. A-4).

5. Reply to Claim that Contractual Minimum Bill and Minimum Take Provisions Are Appropriate for Generic Treatment.

The Commission challenges Transwestern's assertion that Order No. 380 involves "fact specific findings affecting a limited numbers of companies." (Comm. Br. at 22). Disregarding, *arguendo*, the difference between contractually based minimum bills and those incorporated in tariffs unilaterally through Section 4 filings, there is no basis for the contention that minimum take provisions involve "a general issue affecting all natural gas pipelines." Indeed, the Commission is careful not to assert such claim. (Comm. Br. at 22).[6] Under these circumstances, it can hardly be concluded that the requirements of *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 (1978), have been satisfied in the informal rulemaking proceedings underlying Order No. 380. *See* 435 U.S. at 548.

CONCLUSION

Order No. 380 is based on the unprecedented theory that the industry will operate more efficiently if distributor customers have no obligation to purchase gas from their pipeline suppliers. It is significant that neither the Commission nor SoCalGas refers to any of the authorities which address the role of contracts under the Natural Gas Act. The essence of the controversy here is found in the Commission's statement,

> Petitioners' references (85-1219 Pet. 8-10) to the role of contracts under the Natural Gas Act are irrelevant.

(Comm. Br. at 15).

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[6] To Transwestern's knowledge, no more than four or five pipelines have such contract minimum take provisions.

Certiorari should issue to permit review of the decision of the court below.

Respectfully submitted,

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